

General Information Letter: Withholding obligation on Ohio resident employees temporarily performing services within Illinois.

April 13, 1998

Dear

This is in response to your letter dated April 13, 1998, in which you request a General Information Letter. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the information you have provided requires that we respond with a general information letter.

In your request you stated:

We are an Ohio interstate employer and are receiving conflicting information regarding which state should receive withheld income tax. We do not want to evade Illinois income tax laws, we are only seeking to accurately withhold taxes for our employees' benefit. We would appreciate a legal letter ruling on the following situation.

Our company is located in Ohio. We have contracted with an Illinois company to provide consulting services. Our employees, who are Ohio residents, are working on location in Illinois.

The Illinois company pays our Corporate office in Ohio for these services. Payroll for the services is issued from our Ohio office. We are an Ohio withholding agent.

Department Analysis

Section 302(a) of the Illinois Income Tax Act ("IITA") states:

Sec. 302. Compensation Paid To Nonresidents.

(a) In general. All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a

nonresident at the time of such payment and all items of deduction directly allocable thereto, shall be allocated to this State.

Section 304(a)(2)(B) provides:

Compensation is paid in this State if:

(i) The individual's service is performed entirely within this State;

(ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or

(iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

The statute is fleshed out by regulations found at 86 Illinois Administrative Code Chapter 1, Sec. 100.3360 and 100.3120 (attached). From the facts in your letter and the subsequent telephone conversation I had with yourself on April 13, 1998, it appears that if the provision in §304(a)(2)(B)(iii) applies, no withholding will be required. You stated during the phone conversation that the Illinois company contracting with PM Solutions did so by contacting your Ohio office and your employees are controlled from Ohio. As this is a base of operations in a definable state (Ohio), Illinois would not require withholdings for these employees.

Additional information provided in the phone conversation leads one to doubt whether the provisions in §304(a)(2)(B)(i) or (ii) would cause your employers to be subject to Illinois income tax, either. You stated that your company does business throughout the United States and the employees in Illinois can be assigned to work anywhere in the Country. Moreover, the current project in Illinois is only scheduled to last six months. Under these conditions, the §304(2)(a)(B)(i) requirement that employees perform their service entirely within Illinois probably would not apply. Similarly, the §304(a)(2)(B)(ii) condition that employment services outside of Illinois be only incidental to their duties within Illinois would probably not apply if the project ended in June or July (assuming a January start date) and the employees then left Illinois.

The situation becomes unclear in the case of a project which requires an employee to be in Illinois the entire year, or if an employee was assigned to additional projects in Illinois after the finish of the current project. The statute states that if an employee's service is performed entirely within Illinois he or she would be considered as having compensation paid in Illinois. Conversely, if the employee has even one significant project outside of Illinois and the project is not incidental to the work in Illinois, the employee probably could avoid Illinois withholdings. These examples are all based upon the employees being Ohio residents and wishing to remain so.

In sum, the rule on compensation paid in Illinois is very fact-specific and precludes a straightforward answer as to whether compensation is earned in Illinois or not. Accordingly, the taxpayer should take into consideration all

facts and circumstances when determining whether employees working in Illinois earn their compensation in Illinois for withholding purposes.

I hope that this has been helpful to you. If you have additional questions please feel free to contact me at the above address.

Sincerely,

Charles E. Matoesian  
Staff Attorney (Income Tax)